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No. 79-1104

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

E.I. DU PONT DE NEMOURS & COMPANY,
Petitioner,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SUPPLEMENT TO PETITION

DANIEL M. GRIBBON
Covington & Burling
888 Sixteenth Street, N.W.
Washington, D.C. 20006
Attorneys for Petitioner

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The purpose of this Memorandum is to bring to the Court's attention a recent decision of the Court of Appeals for the Second Circuit which gives Section 482 of the Internal Revenue Code and the regulations thereunder an interpretation drastically different from that rendered by the Court of Claims in petitioner's case. This decision further illustrates the conflicting views in the lower courts of this complex and important area of tax law, thus emphasizing the need for review and supervision by this Court.

The decision, *United States Steel Corporation* v. *Commissioner of Internal Revenue*, Nos. 167, 514 (2d Cir. Mar. 12, 1980), involved payments made by a parent to its shipping subsidiary. In refusing to approve a reallocation proposed by

the Commissioner, which had been sustained in part by the Tax Court, the Second Circuit rejected the view that virtual identity between controlled and uncontrolled transactions must be proved under regulatory language requiring that the latter transactions be "similar" to the transaction under scrutiny, to be considered in applying the standard of Section 482.[1] Moreover, the Second Circuit specifically held that "the absence or presence of any intent on the part of the taxpayer to distort his income" is irrelevant in the application of section 482. Slip op. at 1734. In each respect the approach of the Second Circuit sharply contrasts with that of the Court of Claims below, which imposed on petitioner the burden of establishing practical identity between controlled and uncontrolled transactions, and gave great weight to petitioner's stated intention to conduct its foreign operations in a manner that would minimize income taxes.

In *U.S. Steel*, the parent, "Steel," used a fully owned subsidiary, "Navios," to ship iron ore which was produced in Venezuela by another subsidiary, "Orinoco." Since Navios paid Steel no dividends "[i]n effect . . . Navios became an offshore tax shelter." Slip op. at 1730. Income was reallocated to Steel from Navios on the Commissioner's theory that the shipping rates paid by Steel were in excess of arms' length rates.

The Tax Court rejected the evidence proffered by Steel noting that the relationship between it and Navios was so unique that market transactions—even those between Navios and unrelated third parties—were inherently dissimilar and therefore could not be used as an indication of the rates that would have been charged at arms' length. Specifically, the Tax Court was of the view that since Steel and Navios had a continuing relationship, and Navios was thus assured of Steel's

[1] The regulation applied in petitioner's case, pertaining to the sale of goods between related companies, Treas. Reg. §1.482-2(e), and that applied in *U.S. Steel*, pertaining to the provision of services, Treas. Reg. 1.482-2(b), apply the identical statutory standard and are keyed to the same concept of similarity between controlled and uncontrolled transactions.

business, Navios' transactions with unrelated parties, as to which it lacked such assurance, were not relevant. The Tax Court's approach thus was substantially identical to that of the Court of Claims below, in accepting the Government's view that near identity of transactions must be shown under the regulations, and treating a parent-subsidiary relationship as inherently unique.

In rejecting this interpretation of the regulatory standard, the Second Circuit said:

> "We are constrained to reject this argument. Although certain factors made the operations undertaken by Navios for Steel unique—at one point, for example, Navios' ore-carriers were the largest of their kind in the world—the approach taken by the Tax Court would lead to a highly undesirable uncertainty if accepted. In very few industries are transactions truly comparable in the strict sense used by [the Tax Court]. Every transaction in wheat, for example, is more or less the same, except for standard variations in amount, time of delivery and place of delivery. But few products or services are as fungible as wheat. To say that Pittsburgh Steel was buying a service from Navios with one set of expectations about duration and risk, and Steel another, may be to recognize economic reality; but it is also to engraft a crippling degree of economic sophistication onto a broadly drawn statute, which—if 'comparable' is taken to mean 'identical', as [the Tax Court] would read it—*would allow the taxpayer no safe harbor from the Commissioner's virtually unrestricted discretion to reallocate.*" Slip op. at 1742-43 (emphasis by the court) (footnotes omitted).[2]

[2] In one of the omitted footnotes, fn. 11, the Court of Appeals noted the uncertainty, "present in all §482 cases," of the method by which the Commissioner calculates the reallocation of income, pointing out that the Commissioner had reallocated $52 million for a four-year period while the Tax Court had sustained only $25 million of that amount. In this case the difference between the Commissioner and the petitioner amounts to some $18 million for a taxable period of less than two years.

This excerpt from the Second Circuit's opinion states the essence of petitioner's position in this case: the regulations under Section 482 as interpreted by the Court of Claims provide, contrary to the expressed intention of Congress, no protection from the Commissioner's "virtually unrestricted discretion to reallocate." The contrasting analysis of the Second Circuit in rejecting the approach sustained by the Court of Claims below, reflects again the serious and continuing differences among the lower federal courts in this significant area of the tax law, which should be reconciled by the Court at this time.

Respectfully submitted,

DANIEL M. GRIBBON
Covington & Burling
888 Sixteenth Street, N.W.
Washington, D.C. 20006
Attorneys for Petitioner

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